

McGladrey & Pullen

Certified Public Accountants

South Dakota Public Assurance Alliance

Financial Report

12.31.2008

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Certified Public Accountants

Independent Auditor's Report

To the Board of Directors
South Dakota Public Assurance Alliance
Pierre, South Dakota

We have audited the accompanying basic financial statements of the South Dakota Public Assurance Alliance (Pool) as of and for the years ended December 31, 2008 and 2007, as listed in the table of contents. These financial statements are the responsibility of the Pool's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Dakota Public Assurance Alliance as of December 31, 2008 and 2007, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Schedules of Claims Development Information on pages 15 and 16 and the Combining Schedules of the Liability for Losses and Loss Adjustment Expense Reserves on page 17 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it. The Pool has not presented a management's discussion and analysis that accounting principles generally accepted in the United States of America require to supplement, although not to be a part of, the basic financial statements.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Pool's basic financial statements. The combining schedules listed in the table of contents as other supplementary information are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

McGladrey & Pullen, LLP

Sioux Falls, South Dakota
June 18, 2009

South Dakota Public Assurance Alliance

Statements of Net Assets
December 31, 2008 and 2007

Assets	2008	2007
Current Assets		
Cash and cash equivalents	\$ 945,341	\$ 2,013,545
Receivables:		
Contributions	3,277,795	3,462,956
Investment income	184,076	157,320
Reinsurance recoverable on paid losses (Notes 3 and 5)	140,440	53,543
Prepaid expenses	124,648	104,407
Investments (Note 2):		
Certificates of deposit	862,840	675,511
Debt securities	352,181	2,466,012
Total current assets	5,887,321	8,933,294
Noncurrent Assets		
Investments (Note 2):		
Certificates of deposit	4,738,076	3,893,498
Debt securities	16,255,947	13,024,226
Contributed surplus and member equity in NLC Mutual Insurance Company (Note 6)	526,331	526,331
	21,520,354	17,444,055
	\$ 27,407,675	\$ 26,377,349
Liabilities and Net Assets		
Current Liabilities		
Losses and loss adjustment expense reserves (Notes 3 and 5)	\$ 2,379,921	\$ 2,504,625
Accounts payable and accrued expenses	77,110	54,440
Unearned contributions	6,510,393	6,545,123
Total current liabilities	8,967,424	9,104,188
Noncurrent Liabilities		
Losses and loss adjustment expense reserves (Notes 3 and 5)	9,951,578	11,204,887
Unearned contributions, capitalization contributions	144,550	222,187
	10,096,128	11,427,074
Total liabilities	19,063,552	20,531,262
Net Assets - Unrestricted	8,344,123	5,846,087
	\$ 27,407,675	\$ 26,377,349

See Notes to Financial Statements.

South Dakota Public Assurance Alliance

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended December 31, 2008 and 2007

	2008	2007
Operating revenues:		
Contributions:		
Operating, net of renewal, loss control and loss ratio credits of \$383,308 and \$345,825 in 2008 and 2007, respectively (Note 7)	\$ 8,574,104	\$ 8,433,611
Reinsurance premiums ceded (Note 5)	(1,375,685)	(1,484,018)
Net operating revenues	7,198,419	6,949,593
Operating expenses:		
Losses and loss adjustment expenses incurred (Notes 3, 4, and 5)	4,774,660	4,648,463
General and administrative expenses:		
Marketing and administrator's fees (Note 4)	1,620,225	1,678,631
Other (Note 4)	237,190	250,521
Total general and administrative expenses	1,857,415	1,929,152
Total operating expenses	6,632,075	6,577,615
Operating income	566,344	371,978
Nonoperating revenues (expenses):		
Net investment income (Notes 2 and 4)	1,721,981	1,342,794
Total nonoperating revenues	1,721,981	1,342,794
Income before capitalization contributions and distributions	2,288,325	1,714,772
Capitalization contributions	233,433	240,176
Capitalization distributions	(23,722)	(17,204)
Change in net assets	2,498,036	1,937,744
Net assets:		
Beginning of year	5,846,087	3,908,343
End of year	\$ 8,344,123	\$ 5,846,087

See Notes to Financial Statements.

South Dakota Public Assurance Alliance

Statements of Cash Flows

Years Ended December 31, 2008 and 2007

	2008	2007
Cash Flows From Operating Activities		
Operating contributions received	\$ 8,724,535	\$ 8,887,244
Reinsurance premiums paid	(1,375,685)	(1,484,018)
Losses and loss adjustment expenses paid	(6,239,570)	(4,556,974)
General and administrative expenses paid	(1,854,986)	(2,056,576)
Net cash provided by (used in) operating activities	(745,706)	789,676
Cash Flows From Noncapital Financing Activities		
Cumulative reserve contributions received	155,796	162,827
Cumulative reserve contributions paid	(23,722)	(17,204)
Net cash provided by noncapital financing activities	132,074	145,623
Cash Flows From Investing Activities		
Debt securities:		
Purchases	(5,534,768)	(6,273,687)
Maturities and calls	4,102,044	5,890,761
Repayments on mortgage-backed securities	996,474	929,689
Proceeds from maturities of certificates of deposit	776,500	449,824
Purchases of certificates of deposit	(1,802,418)	(1,612,627)
Investment income received, net of investment expenses	1,007,596	945,053
Net cash provided by (used in) investing activities	(454,572)	329,013
Net increase (decrease) in cash and cash equivalents	(1,068,204)	1,264,312
Cash and Cash Equivalents		
Beginning of year	2,013,545	749,233
End of year	\$ 945,341	\$ 2,013,545
Reconciliation of operating income to net cash provided by (used in) operating activities:		
Operating income	\$ 566,344	\$ 371,978
(Increase) decrease in assets:		
Contributions receivable	185,161	(279,984)
Reinsurance recoverable on paid losses	(86,897)	(42,709)
Prepaid expenses	(20,241)	14,427
Increase (decrease) in liabilities:		
Losses and loss adjustment expense reserves	(1,378,013)	134,198
Accounts payable and accrued expenses	22,670	(141,851)
Unearned contributions	(34,730)	733,617
Net cash provided by (used in) operating activities	\$ (745,706)	\$ 789,676
Supplemental Disclosure of Noncash Investing and Financing Activity		
Net increase in the fair value of investments	\$ 681,640	\$ 423,856

See Notes to Financial Statements.

South Dakota Public Assurance Alliance

Notes to Financial Statements

Note 1. Nature of Business and Significant Accounting Policies

Reporting Entity: The South Dakota Public Assurance Alliance (Pool) is a local government risk-sharing pool whose 371 members are various governmental entities throughout South Dakota. The Pool was formed in December 1986 for the primary purpose of managing and funding third-party claims against its members. An Intergovernmental Contract governs the operations of the Pool. The administration of the Intergovernmental Contract and management of the Pool are performed by a Board of Directors of not more than 9 members.

The Pool operates as a single proprietary fund, more specifically as an enterprise fund. The Pool distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services in connection with the Pool's principal ongoing operations. Nonoperating revenues and expenses result primarily from investment activities.

Nature of business: The Board of Directors has designated an "Operating Fund" and a "Cumulative Reserve Fund", the sum of these amounts comprise Net Assets – Unrestricted in the Pool's statements of net assets. Amounts in the Operating Fund are adjusted by changes in net assets resulting from other than capitalization contributions, which are net of distributions of capitalization contributions. As of December 31, 2008 and 2007, the Operating Fund had a deficiency of \$(2,172,859) and \$(4,572,904), respectively, and the Cumulative Reserve Fund had a balance of \$10,516,982 and \$10,418,991, respectively. In the event that the Operating Fund is exhausted during any Pool fiscal year, any funds required to fulfill the purpose of the Operating Fund will be allocated from the Cumulative Reserve Fund. The sum so allocated constitutes a deficiency in the Cumulative Reserve Fund. This deficiency in the Cumulative Reserve Fund will be allocated to the members at the time withdrawn, on a pro rata basis determined by the Board of Directors. This deficit in the Cumulative Reserve Fund will be made up in subsequent years with any excess of income over expenses in the Operating Fund being transferred to the Cumulative Reserve Fund.

Members with casualty risk coverage provided by the Pool, agree to make annual operating contributions to the Pool, a portion of which are deemed "capitalization contributions" and are made in six annual installments according to the following schedule:

	Percent of "basis rate"
Initial contribution	100%
First anniversary	75
Second anniversary	50
Third anniversary	30
Fourth anniversary	25
Fifth anniversary	20

Subsequent to the fifth anniversary, additional capitalization contributions are required only if the Pool's Board of Directors determine that such contributions are necessary to maintain the Cumulative Reserve Fund at a level equal to 300% of the total current basis rates of all members or to comply with the requirements of any applicable regulatory authority having jurisdiction over the Pool. Capitalization contributions do not apply to members with property risk coverage.

"Basis rate" is that amount annually promulgated by the administrator of the Pool which is deemed necessary to provide the scope of coverage afforded to a member for the period of one year corresponding to the risk sharing certificate effective date, with due consideration to the member's individual characteristics.

South Dakota Public Assurance Alliance

Notes to Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (continued)

Nature of business (continued): Members agree to continue membership for a period of not less than one full year. At the conclusion of such period, or anniversary thereof, a member who has given sixty days prior written notice to the Pool may withdraw. Within 120 days following withdrawal, or as soon thereafter as the next annual budget is completed, the Pool will refund to the withdrawing member that percentage of those capitalization contributions made to the Pool under casualty risk coverage, according to the following schedule:

End of member's first full year	50%
End of member's second full year	60%
End of member's third full year	70%
End of member's fourth full year	80%
End of member's fifth full year	90%
End of member's sixth full year and thereafter	100%

The Pool will deduct from such refund, the member's contribution, which the withdrawing member would have made for the one-year period following withdrawal together with the withdrawing member's proportionate share (determined in accordance with the Intergovernmental Contract) of any deficiency in the Cumulative Reserve Fund.

A member cannot obtain property risk coverage without having casualty risk coverage and a member's election to cease participation in the Pool for property risk coverage does not constitute a withdrawal under any other terms and conditions of the Intergovernmental Contract. Property risk coverage applies only to losses or claims, which occur prior to the termination date. All rights for reimbursement or any right to claim against the Pool terminate for property risk losses, which occur after the termination date.

Effective on the date of withdrawal, payments for all known and unknown casualty risk coverage claims and claims expense thereafter become the sole responsibility of the withdrawing member without regard to whether a claim occurred or was reported prior to the withdrawal of the member's participation in the Pool.

Effective on the date of withdrawal, payments for all property risk claims and claims expense which occurred thereafter, become the sole responsibility of the withdrawing member. The Pool will cover any property claim reported in a timely manner not to exceed sixty days after its occurrence, if the claim occurred during the period the risk sharing certificate was in effect and if coverage was otherwise available under the risk sharing certificate.

The Pool may, by a two-thirds (2/3) majority of the Board of Directors and by providing a member sixty days prior written notice, cancel that member's participation in the Pool and terminate its Intergovernmental Contract effective at the end of any risk sharing certificate year. Thereafter, it is the responsibility of the Pool to defend, settle and pay claims within the scope and limits set forth in the cancelled member's risk sharing certificate in effect on the date of the occurrence out of which such claim arose. This provision applies solely to claims, which occurred during a member's participation and evidenced by the member's risk sharing certificate. The cancelled member has the right, prior to the actual date of cancellation, to withdraw from the Pool by giving notice of such withdrawal. Electing to withdraw, the member shall be subject to the withdrawal provisions of the Intergovernmental Contract. Failing to elect to give notice of withdrawal, the cancelled member forfeits all rights to refund of those capitalization contributions made to the Pool by said cancelled member.

South Dakota Public Assurance Alliance

Notes to Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (continued)

Nature of business (continued): Any member failing to make payments when due as required by the Intergovernmental Contract, will be terminated from the Pool effective on the date the payment was due and upon that effective date of termination all coverages and benefits thereunder cease. All known and unknown claims and claims expenses thereafter become the sole responsibility of the terminated member without regard to whether a claim occurred or was reported prior to the termination of the member's participation in the Pool. The terminated member also forfeits all rights to any return of contributions including its vested interest in the Cumulative Reserve Fund. The Pool will apply any or all of the terminated member's forfeited funds to the Operating Fund. If the member subsequently submits its payment, the administrator may, in its discretion, reinstate such membership.

In the event that a claim or a series of claims exceeds the amount of risk sharing protection provided by the member's risk sharing certificate, or in the event that a claim or a series of claims should exhaust the Operating Fund, the Cumulative Reserve Fund and any reinsurance, then payment of valid claims are the sole and separate obligation of the individual member or members against whom the claim was made and perfected by litigation or settlement.

The Pool will terminate at such time as two-thirds (2/3) of the members vote for such termination. After a vote to terminate, the Board of Directors will commence with the orderly liquidation of the Pool's business and will complete the same as promptly as possible. During such period of liquidation the Pool will continue to pay claims and losses incurred within the scope of coverage and pursuant to the risk sharing certificate until all funds of the Pool are exhausted. After payment of all claims and losses, any remaining funds held by the Pool will be paid to all members of the Pool at the time of the vote of termination, on a pro rata basis determined by the Board of Directors.

To the extent of the existence of funds in the Operating Fund and Cumulative Reserve Fund, no member shall be responsible for any claim, claims, judgment or judgments against any other member or members. If upon termination of the Pool the remaining assets of the Pool are insufficient to satisfy indebtedness of the Pool (excluding claims or judgments against the members), such deficiency will be made up by assessments against members of the Pool on a pro rata basis determined by the Board of Directors.

The Pool is exposed to various risks of loss related to torts and errors and omissions. The Pool has purchased commercial insurance to mitigate its risks.

A summary of the Pool's significant accounting policies follows:

Basis of presentation: The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. The Pool prepares its financial statements primarily following the guidance of Governmental Accounting Standards Board (GASB) Statement No. 10, "Accounting and Financial Reporting for Risk Financing and Related Insurance Issues" (as amended by subsequent GASB statements) along with other applicable standards issued by the GASB as well as applicable standards issued by the Financial Accounting Standards Board (FASB), except those that conflict with or contradict GASB pronouncements. GASB Statement No. 10 establishes accounting and financial reporting standards for risk financing and insurance-related activities of public entity risk pools.

South Dakota Public Assurance Alliance

Notes to Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (continued)

Use of estimates: The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the estimated liability for losses and loss adjustment expense reserves and the determination of estimated fair values of investments.

Cash and cash equivalents: For purposes of reporting the statements of cash flows, the Pool includes as cash equivalents all cash accounts and money market mutual funds which are not subject to withdrawal restrictions or penalties. Certificates of deposit are considered investments as all have been purchased with maturities in excess of ninety days.

Investments: Investment securities are accounted for under the provisions of GASB Statement No. 31. Under GASB No. 31, the Pool is required to report investments (other than certificates of deposit) at fair value in the statement of net assets with changes in the fair value of investments reported as investment income. Certificates of deposit are stated at cost.

Dividend and interest income are recognized when earned.

The calculation of realized gains and losses is independent of the calculation of the net increase (decrease) in the fair value of investments. Realized gains and losses on investments that had been held for more than one year and sold in the current year may have been recognized as an increase or decrease in the fair value of investments reported in the prior year.

The Pool's Board of Directors has authorized investments in certificates of deposit, United States Treasury and government agency issues, mortgage-backed securities and mutual funds, among other investments.

Member equity in NLC Mutual Insurance Company: The Pool records its share of net increases (decreases) in net assets - unrestricted as income (loss) in the Pool's statement of revenues and expenses and adds (deducts) such amounts to (from) the investment account.

Reinsurance: In the normal course of business, the Pool seeks to reduce the loss that may arise from events that cause unfavorable underwriting results, by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers.

Amounts recoverable from reinsurers under excess loss coverages are estimated in a manner consistent with the development of the estimated liability for losses and loss adjustment expense reserves.

South Dakota Public Assurance Alliance

Notes to Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (continued)

Losses and loss adjustment expense reserves: The Pool establishes loss reserves based upon estimates of the ultimate cost of losses, including future loss adjustment expenses related to claims that have been reported but not settled and of claims that have been incurred but not reported. The length of time for which such costs must be estimated varies depending on the type of coverage involved.

The estimated liability for losses and loss adjustment expenses is based upon data developed by the Pool's administrator. Industry experience and statistics were used to develop the estimated liability. The claims history of the Pool was also considered.

As adjustments to this estimated liability become necessary, such adjustments are reflected in current operations. Management of the Pool believes the estimated liability for losses and loss adjustment expense reserves is sufficient to cover the ultimate net cost of incurred claims, but such reserves are necessarily based on estimates and the ultimate liability may be greater or less than the amounts estimated. An independent actuary assisted management with the establishment of estimated claims liabilities at December 31, 2008 and 2007.

Capitalization contributions and unearned contributions: Casualty capitalization contributions are accounted for under the provisions of GASB Interpretation No. 4, "Accounting and Financial Reporting for Capitalization Contributions to Public Entity Risk Pools" (Interpretation No. 4). Under Interpretation No. 4, capitalization contributions to pools to which risk is transferred must be accounted for as revenue by initially recording such contributions as unearned contributions, then amortizing them into revenue over an appropriate period not to exceed 10 years. Unearned contributions resulting from the application of Interpretation No. 4 are being amortized pro rata over a six-year period, the period over which capitalization contributions are allocated.

Operating contributions and unearned contributions: Members are billed annually in advance for operating contributions. Income from such contributions is recorded as earned during the coverage period. Contributions received in advance for coverage in the following year are recorded as unearned contributions. Revenue is reduced by reinsurance premiums ceded to the reinsurance companies.

Income taxes: The Pool has received a private letter ruling from the Internal Revenue Service, dated December 7, 1987, to the effect that the Pool's income is excludable from gross income under Section 115 of the Internal Revenue Code and is thus exempt from federal income taxes. Management believes that the Pool continues to operate in a manner whereby it continues to be tax exempt.

Premium deficiency: A premium deficiency exists when the sum of expected claims costs (including an estimated liability for unreported claims) and all expected claims adjustment expenses, expected dividends, and policy acquisition costs exceed related unearned premiums. The Pool anticipates investment income in determining if a premium deficiency exists. No premium deficiency existed as of December 31, 2008 and 2007.

Recent accounting pronouncements: The GASB and FASB have issued certain accounting standards, which have required effective dates occurring after the Pool's December 31, 2008 year end. The Pool's financial statements are not expected to be materially affected by those accounting pronouncements.

South Dakota Public Assurance Alliance

Notes to Financial Statements

Note 2. Deposits and Investments

As of December 31, 2008, the Pool had the following investments:

Investment Type	Fair Value/ Carrying Value	Effective Duration (In Years)
U.S. government corporations and agencies	\$ 7,454,163	3.19
Mortgage-backed securities	9,153,965	2.41
Certificates of deposit	5,600,916	2.25
	\$ 22,209,044	2.53

As of December 31, 2007, the Pool had the following investments:

Investment Type	Fair Value/ Carrying Value	Effective Duration (In Years)
U.S. government corporations and agencies	\$ 8,339,984	2.28
Mortgage-backed securities	7,150,254	3.88
Certificates of deposit	4,569,009	2.68
	\$ 20,059,247	2.69

As of December 31, 2008, the Fund had the following investments (other than those explicitly guaranteed by the U.S. government) which exceed 5% of the total investment portfolio:

	Percentage of Portfolio
Federal Home Loan Bank	5.6
Federal Home Loan Bank	5.4
FNMA Federal National Mortgage Association	5.4
Freddie Mac	5.4
Government National Mortgage Association	5.5
Government National Mortgage Association	5.4

South Dakota Public Assurance Alliance

Notes to Financial Statements

Note 2. Deposits and Investments (continued)

As of December 31, 2007, the Fund had the following investments (other than those explicitly guaranteed by the U.S. government) which exceed 5% of the total investment portfolio:

	Percentage of Portfolio
Federal Home Bank	6.3
Federal Home Bank	6.0
Federal National Mortgage Association	6.2

The net increase in the fair value of investments was \$681,640 and \$423,856 during 2008 and 2007, respectively. These amounts take into account all changes in fair value (including purchases and sales) that occurred during the year.

Custodial credit risk: The Pool's cash and cash equivalents are comprised of money market and checking accounts. Custodial credit risk is the risk that in the event of a bank failure, the Pool's deposits may not be returned to it. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (i.e. broker-dealer) to a transaction, a government will not be able to recover the value of its investments that are in the possession of another party. As of December 31, 2008 and 2007, \$890,145 and \$2,007,992 of the Pool's bank balance was exposed to custodial credit risk as uninsured and uncollateralized, which are money market funds that are not federally insured and held by the counterparty's trust department.

Interest rate risk: The Pool's investment policy provides for the avoidance of undue concentration in the maturity of bonds in the portfolio and the effective duration of the portfolio is limited to no longer than 4 years. The investment policy also provides that at least \$300,000 or more of investments should mature within 20 days or less.

Credit risk: The Pool's investment policy provides that all investments be federally insured, protected against loss as provided in SDCL 4-6A-9 as "public deposits" in qualified public depositories, or meet the requirements of SDCL 4-5-6, which allows investments in (a) securities of the United States and securities guaranteed by the United States government either directly or indirectly; or (b) repurchase agreements fully collateralized by securities described in (a) above; or in shares of an open-end, no-load fund administered by an investment company whose investments are in securities described in (a) above and repurchase agreements described in (b) above. The Pool has no investment policy that would further limit its investment choices other than as described in its investment footnote disclosures. The credit rating obtained by Standard & Poor's or Moodys for all U.S. government corporations and agencies and mortgage-backed securities held by the Pool is AAA as of December 31, 2008 and 2007.

Concentration of credit risk: The Pool's investment policy provides that securities issued directly by or indirectly guaranteed by the United States Government (including, but not limited to U.S. treasury securities and securities issued by or guaranteed by the Government National Mortgage Association) may be owned without limit. The aggregate market value of all unsecured obligations issued by or guaranteed by government sponsored enterprises which are not direct or indirect obligations of the U.S. Treasury (including, but not limited to Fannie Mae, Freddie Mac, and the Federal Home Loan Bank) are limited to 60% of the market value of the portfolio. This limitation does not apply to collateralized obligations guaranteed by these government sponsored enterprises (including, but not limited to mortgage-backed pass-through securities). The aggregate market value of all certificates of deposit owned in the portfolio cannot exceed 75% of the market value of the portfolio. The use of leverage and direct investment in derivative securities is prohibited.

South Dakota Public Assurance Alliance

Notes to Financial Statements

Note 3. Liability for Losses and Loss Adjustment Expense Reserves

The Pool establishes liabilities for both reported and unreported covered events, which includes estimates of both future payments of claims and related claims adjustment expenses. The following is a summary of the changes in those aggregate liabilities for the years ended December 31, 2008 and 2007.

	2008	2007
Unpaid losses and loss adjustment expense reserves at beginning of year	\$ 13,709,512	\$ 13,575,314
Less reinsurance recoverable at beginning of year	(53,543)	(10,834)
Net unpaid losses and loss adjustment expense reserves at beginning of year	<u>13,655,969</u>	<u>13,564,480</u>
Net incurred losses and loss adjustment expenses:		
Current year provision	6,719,577	5,949,780
Decrease in prior years' provisions	(1,944,917)	(1,301,317)
Net provision	<u>4,774,660</u>	<u>4,648,463</u>
Net losses and loss adjustment expense payments attributable to:		
Current year	(2,702,639)	(2,287,455)
Prior years	(3,536,931)	(2,269,519)
Net payments	<u>(6,239,570)</u>	<u>(4,556,974)</u>
Net unpaid losses and loss adjustment expense reserves at end of year	12,191,059	13,655,969
Plus reinsurance recoverable at end of year	140,440	53,543
Unpaid losses and loss adjustment expense reserves at end of year	<u>\$ 12,331,499</u>	<u>\$ 13,709,512</u>

As a result of changes in estimates of insured events in prior years, the provision for losses and loss adjustment expense reserves decreased by approximately \$1,945,000 and \$1,300,000 in 2008 and 2007, respectively. The change in incurred losses was primarily attributable to new information regarding claim development that became known during each period.

Note 4. Agreements

Hagan Benefits, Inc. (HBI) performs the program administration, marketing, underwriting, billing and collection services for the Pool. Total fees incurred under the HBI agreements were \$1,620,225 and \$1,678,631 in 2008 and 2007, respectively, and are included in general and administrative expenses in the statements of revenues and expenses. The agreements with HBI expire December 31, 2009.

The Pool has agreements with Claims Associates, Inc. (CAI) to provide administrative, investigative, and adjustment services for claims incurred. The agreements provide for a flat fee for claims administration services with varying fees for claims adjustment expenses incurred. The agreements expire December 31, 2009. Total fees incurred under these agreements in 2008 and 2007 were \$998,854 and \$881,778, respectively, and are included in losses and loss adjustment expenses in the statements of revenues and expenses.

The Pool has agreements with Safety Benefits, Inc. to provide property valuation and loss control programs for members. These agreements state that Safety Benefits, Inc. be compensated based on a flat fee. The property valuation agreement expired December 31, 2008, and was subsequently renewed through December 31, 2010. The loss control program agreement expires December 31, 2009. Fees incurred under the agreements in 2008 and 2007 were \$364,370 and \$352,150 respectively, and are included in losses and loss adjustment expenses in the statements of revenues and expenses.

The Pool maintains agency accounts with the First National Bank of Sioux Falls (FNB) under a custodial agreement. Fees incurred to FNB in 2008 and 2007 were \$59,718 and \$55,349, respectively, and are netted against investment income in the statements of revenues and expenses.

The South Dakota Municipal League (SDML) is the sponsoring organization of the Pool. SDML provides information and support services to the Pool. Fees incurred to SDML in 2008 and 2007 were \$72,935 and \$70,240, respectively, and are included in general and administrative expenses in the statements of revenues and expenses.

Note 5. Reinsurance

The Pool has a casualty reinsurance agreement in which the Pool retains casualty risks up to \$500,000 per claim in 2008 and 2007, and claims exceeding the retention are reinsured in amounts ranging from \$500,000 to \$6,000,000 of loss per occurrence in both 2008 and 2007.

The Pool also has property reinsurance in which the Pool retains property risks up to \$250,000 per claim in an amount not to exceed \$250,000,000 per occurrence in 2008 and 2007.

The Pool would be liable for any obligations that the reinsurance companies are unable to meet under the reinsurance agreements. Reinsurance amounts of \$2,571,568 and \$4,796,056 were deducted from the estimated liability for losses and loss adjustment expense reserves in 2008 and 2007, respectively. During 2008 and 2007, the Pool received \$585,072 and \$428,876 of recoveries from the reinsurance companies under contract.

South Dakota Public Assurance Alliance

Notes to Financial Statements

Note 6. NLC Mutual

In prior years, the Pool had property and casualty reinsurance coverages with NLC Mutual Insurance Company (NLC Mutual), and has since placed these coverages with other companies. Within each line of business of NLC Mutual, each member pool has a separate equity account that is comprised of the member's contributed surplus and member equity. Contributed surplus requirements are determined as specified in NLC Mutual's by-laws.

Each NLC Mutual member's equity account may be credited each year with the member's proportionate share of realized investment income earned by NLC Mutual during the prior fiscal year based on the total of all members' equity accounts at NLC Mutual's discretion. Further, each member's equity account may also be credited (or debited) from time to time based on NLC Mutual's financial condition, underwriting results, reserve adjustments, and such other factors as NLC Mutual may reasonably consider in order to achieve fair and equitable results for NLC Mutual.

At the sole discretion of each NLC Mutual pool member, an election may be made to withdraw its total equity from any line of business reinsured by giving written notice to NLC Mutual. The effective date upon which such equity may be withdrawn shall be determined by the withdrawing member based on a distribution election of no sooner than 2 years at 20% of equity and no longer than 10 years at 100% of equity. This distribution of equity also requires the approval of NLC Mutual's Board of Directors and the State of Vermont Department of Banking, Insurance, Securities and Health Care Administration.

Effective December 31, 2006, the Pool withdrew from the property and casualty coverages of NLC Mutual and anticipates that it will receive its equity balances with NLC Mutual at December 31, 2016. The Pool made no capital contributions to NLC Mutual related to casualty or property coverages in 2008 and 2007. As of December 31, 2008 and 2007, the Pool's equity balance was \$526,331.

Note 7. Member Contributions

Renewal credits were \$47,696 and \$91,645 under the casualty line and \$37,239 and \$16,141 under the property line during the years ended December 31, 2008 and 2007, respectively. Loss control credits were \$79,185 and \$112,797 under the casualty line and \$59,227 and \$19,394 under the property line during the years ended December 31, 2008 and 2007, respectively. Loss ratio credits were \$91,407 and \$86,685 under the casualty line and \$68,554 and \$19,163 under the property line during the years ended December 31, 2008 and 2007, respectively. Renewal, loss control and loss ratio credits are reported as a reduction of member contributions earned in the year in which the member renews.

South Dakota Public Assurance Alliance

Required Supplementary Information - Schedule of Claims Development Information (Casualty) - Unaudited
For the Ten Years Ended December 31, 2008

	*1999	*2000	*2001	*2002	*2003	2004	2005	2006	2007	2008
Net earned member contributions and investment income:										
Earned	\$ 6,146,717	\$ 5,294,578	\$ 5,877,161	\$ 5,117,873	\$ 7,085,676	\$ 4,647,134	\$ 5,566,726	\$ 5,598,882	\$ 6,744,025	\$ 6,711,349
Ceded	527,771	439,011	478,288	605,861	882,528	610,059	637,369	732,588	935,998	916,388
Net earned	5,618,946	4,855,567	5,398,873	4,512,012	6,203,148	4,037,075	4,929,357	4,866,294	5,808,027	5,794,961
Unallocated expenses	1,213,829	1,508,810	1,676,017	1,375,632	1,463,841	1,342,455	1,068,062	1,165,105	1,273,123	1,246,186
Estimated claims and expenses, end of policy year:										
Incurred	3,983,173	2,800,028	3,225,428	2,933,838	4,890,788	4,821,603	4,835,473	4,323,271	4,429,774	4,544,518
Ceded	343,961	265,691	344,124	456,183	722,756	-	-	-	-	-
Net incurred	3,639,212	2,534,337	2,881,304	2,477,655	4,168,032	4,821,603	4,835,473	4,323,271	4,429,774	4,544,518
Net paid (cumulative) as of:										
End of policy year	517,566	325,428	520,345	458,055	617,802	874,169	861,770	823,766	1,004,961	1,139,743
One year later	834,311	660,531	948,277	1,010,479	1,175,258	1,523,325	1,449,117	1,277,056	1,910,876	
Two years later	1,208,626	792,480	1,652,279	1,669,320	1,593,084	1,911,996	1,712,797	1,582,727		
Three years later	2,019,738	1,101,185	1,933,209	2,479,592	1,913,479	2,519,100	2,001,130			
Four years later	2,428,582	1,185,566	2,020,956	2,669,911	2,049,265	2,981,707				
Five years later	2,514,858	1,295,934	2,046,821	2,914,859	2,119,009					
Six years later	2,562,548	1,435,822	2,069,799	3,765,262						
Seven years later	2,624,892	1,445,219	2,080,860							
Eight years later	2,658,775	1,455,684								
Nine years later	2,678,130									
Reestimated ceded claims and expenses	220,824	51,528	-	-	314,987	1,903,590	76,683	-	-	-
Reestimated net incurred claims and expenses:										
End of policy year	3,639,212	2,534,337	2,881,304	2,477,655	4,168,032	4,821,603	4,835,473	4,323,371	4,429,774	4,544,518
One year later	3,172,004	2,281,228	2,708,859	3,029,003	3,624,157	4,110,676	4,318,049	3,560,032	4,466,672	
Two years later	2,703,223	1,734,768	2,497,852	4,001,195	2,659,094	4,044,965	3,380,071	2,788,569		
Three years later	2,868,655	1,667,816	2,528,159	4,062,162	2,493,561	4,240,673	2,799,933			
Four years later	2,886,501	1,650,581	2,189,273	4,342,696	2,381,851	3,890,919				
Five years later	3,842,157	1,671,114	2,165,723	4,367,531	2,298,426					
Six years later	3,792,579	1,462,017	2,108,148	4,267,545						
Seven years later	3,836,053	1,506,163	2,136,963							
Eight years later	3,815,940	1,511,133								
Nine years later	3,916,860									
Increase (decrease) in estimated net incurred claims and expenses from end of policy year	\$ 277,648	\$ (1,023,204)	\$ (744,341)	\$ 1,789,890	\$ (1,869,606)	\$ (930,684)	\$ (2,035,540)	\$ (1,534,802)	\$ 36,898	\$ -

* Amounts related to 2003 and prior years were derived from amounts presented in audited financial statements from the Pool's previous auditors, and such information has not been modified in this table.

South Dakota Public Assurance Alliance

Required Supplementary Information - Schedule of Claims Development Information (Property) - Unaudited
For the Ten Years Ended December 31, 2008

	*1999	*2000	*2001	*2002	*2003	2004	2005	2006	2007	2008
Net earned member contributions and investment income:										
Earned	\$ 553,629	\$ 847,812	\$ 1,152,068	\$ 5,422,862	\$ 1,336,102	\$ 2,811,931	\$ 2,754,020	\$ 3,125,832	\$ 3,032,380	\$ 2,903,096
Ceded	47,945	93,624	50,232	4,016,000	980	731,758	771,872	497,955	548,020	459,297
Net earned	505,684	754,188	1,101,836	1,406,862	1,335,122	2,080,173	1,982,148	2,627,877	2,484,360	2,443,799
Unallocated expenses	279,699	376,120	410,052	647,198	811,557	887,489	565,369	572,380	656,029	611,229
Estimated claims and expenses, end of policy year:										
Incurred	270,708	469,392	718,209	4,766,502	513,742	1,072,448	1,455,634	1,750,821	1,948,882	2,175,059
Ceded	47,945	93,624	50,232	4,016,000	980	129,164	362,367	719,569	428,876	-
Net incurred	222,763	375,768	667,977	750,502	512,762	943,284	1,093,267	1,031,252	1,520,006	2,175,059
Net paid (cumulative) as of:										
End of policy year	201,346	247,588	399,772	766,912	391,142	561,722	704,946	738,241	1,282,494	1,562,896
One year later	251,874	297,662	538,043	936,288	500,070	777,522	1,103,923	926,907	1,545,693	
Two years later	256,160	305,731	697,971	903,386	499,760	781,245	1,108,535	911,835		
Three years later	256,241	493,588	698,921	753,350	500,248	786,593	1,112,467			
Four years later	317,271	493,588	700,932	753,350	500,247	789,127				
Five years later	315,926	493,588	700,932	753,350	500,247					
Six years later	312,284	493,588	699,045	753,350						
Seven years later	312,284	493,628	699,045							
Eight years later	312,324	493,628								
Nine years later	312,324									
Reestimated ceded claims and expenses	-	-	-	3,052,884	-	-	92,131	1,757,644	156,358	60,477
Reestimated net incurred claims and expenses:										
End of policy year	222,763	375,768	667,977	750,502	512,762	943,284	1,093,267	1,031,252	1,520,006	2,175,059
One year later	267,119	348,033	553,811	2,289,767	555,461	803,280	1,150,800	974,124	1,583,185	
Two years later	256,791	305,815	710,620	912,756	513,159	800,174	1,128,045	911,835		
Three years later	256,615	493,588	713,117	753,722	500,248	789,006	1,115,555			
Four years later	317,416	493,588	700,932	753,349	500,247	793,027				
Five years later	315,931	493,588	700,932	753,350	500,247					
Six years later	312,284	493,588	699,045	753,350						
Seven years later	312,284	493,628	699,045							
Eight years later	312,324	493,628								
Nine years later	312,324									
Increase (decrease) in estimated net incurred claims and expenses from end of policy year	\$ 89,561	\$ 117,860	\$ 31,068	\$ 2,848	\$ (12,515)	\$ (150,257)	\$ 22,288	\$ (119,417)	\$ 63,179	\$ -

South Dakota Public Assurance Alliance

Required Supplementary Information - Combining Schedules of the Liability for Losses and Loss Adjustment Expense Reserves
Years Ended December 31, 2008 and 2007

	2008			2007		
	Casualty	Property	Total	Casualty	Property	Total
Unpaid losses and loss adjustment expense reserves at beginning of year	\$ 13,179,074	\$ 530,438	\$ 13,709,512	\$ 13,222,209	\$ 353,105	\$ 13,575,314
Less reinsurance recoverable at beginning of year	-	(53,543)	(53,543)	-	(10,834)	(10,834)
Net unpaid losses and loss adjustment expense reserves at beginning of year	13,179,074	476,895	13,655,969	13,222,209	342,271	13,564,480
Net incurred losses and loss adjustment expenses:						
Current year provision	4,544,518	2,175,059	6,719,577	4,429,774	1,520,006	5,949,780
Increase (decrease) in prior years' provisions	(1,929,390)	(15,527)	(1,944,917)	(1,129,505)	(171,812)	(1,301,317)
Net provision	2,615,128	2,159,532	4,774,660	3,300,269	1,348,194	4,648,463
Net losses and loss adjustment expense payments attributable to:						
Current year	(1,139,743)	(1,562,896)	(2,702,639)	(1,004,961)	(1,282,494)	(2,287,455)
Prior years	(2,998,081)	(538,850)	(3,536,931)	(2,338,443)	68,924	(2,269,519)
Net payments	(4,137,824)	(2,101,746)	(6,239,570)	(3,343,404)	(1,213,570)	(4,556,974)
Net unpaid losses and loss adjustment expense reserves at end of year	11,656,378	534,681	12,191,059	13,179,074	476,895	13,655,969
Plus reinsurance receivable at end of year	79,963	60,477	140,440	-	53,543	53,543
Unpaid losses and loss adjustment expense reserves at end of year	\$ 11,736,341	\$ 595,158	\$ 12,331,499	\$ 13,179,074	\$ 530,438	\$ 13,709,512

South Dakota Public Assurance Alliance

Combining Schedules of Net Assets

December 31, 2008

Assets	Casualty	Property	Total
Current Assets			
Cash and cash equivalents	\$ 666,363	\$ 278,978	\$ 945,341
Receivables:			
Contributions	2,377,020	900,775	3,277,795
Investment income	184,076	-	184,076
Reinsurance recoverable on paid losses	79,963	60,477	140,440
Interdivisional accounts receivable	-	2,812,843	-
Prepaid expenses	89,243	35,405	124,648
Investments:			
Certificates of deposit	862,840	-	862,840
Debt securities	352,181	-	352,181
Total current assets	4,611,686	4,088,478	5,887,321
Noncurrent Assets			
Investments:			
Certificates of deposit	4,738,076	-	4,738,076
Debt securities	16,255,947	-	16,255,947
Contributed surplus and member equity in NLC Mutual Insurance Company	262,694	263,637	526,331
	<u>21,256,717</u>	<u>263,637</u>	<u>21,520,354</u>
	<u>\$ 25,868,403</u>	<u>\$ 4,352,115</u>	<u>\$ 27,407,675</u>
Liabilities and Net Assets			
Current Liabilities			
Losses and loss adjustment expense reserves	\$ 1,966,456	\$ 413,465	\$ 2,379,921
Accounts payable and accrued expenses	65,606	11,504	77,110
Unearned contributions	4,510,137	2,000,256	6,510,393
Interdivisional accounts payable	2,812,843	-	-
Total current liabilities	9,355,042	2,425,225	8,967,424
Noncurrent Liabilities			
Losses and loss adjustment expense reserves	9,769,885	181,693	9,951,578
Unearned contributions, capitalization contributions	144,550	-	144,550
	<u>9,914,435</u>	<u>181,693</u>	<u>10,096,128</u>
Total liabilities	19,269,477	2,606,918	19,063,552
Net Assets - Unrestricted	6,598,926	1,745,197	8,344,123
	<u>\$ 25,868,403</u>	<u>\$ 4,352,115</u>	<u>\$ 27,407,675</u>

* Eliminated during combination

South Dakota Public Assurance Alliance

Combining Schedules of Revenues, Expenses and Changes in Net Assets
Year Ended December 31, 2008

	Casualty	Property	Total
Operating revenues:			
Contributions:			
Operating, net of credits	\$ 5,688,288	\$ 2,885,816	\$ 8,574,104
Reinsurance premiums ceded	(916,388)	(459,297)	(1,375,685)
Net operating revenues	<u>4,771,900</u>	<u>2,426,519</u>	<u>7,198,419</u>
Operating expenses:			
Losses and loss adjustment expenses incurred	<u>2,615,128</u>	<u>2,159,532</u>	<u>4,774,660</u>
General and administrative expenses:			
Marketing and administrator's fees	1,082,050	538,175	1,620,225
Other	164,136	73,054	237,190
Total general and administrative expenses	<u>1,246,186</u>	<u>611,229</u>	<u>1,857,415</u>
Total operating expenses	<u>3,861,314</u>	<u>2,770,761</u>	<u>6,632,075</u>
Operating income (loss)	<u>910,586</u>	<u>(344,242)</u>	<u>566,344</u>
Nonoperating revenues (expenses):			
Net investment income	1,704,701	17,280	1,721,981
Total nonoperating revenues	<u>1,704,701</u>	<u>17,280</u>	<u>1,721,981</u>
Income (loss) before capitalization contributions and distributions	<u>2,615,287</u>	<u>(326,962)</u>	<u>2,288,325</u>
Capitalization contributions	233,433	-	233,433
Capitalization distributions	(23,722)	-	(23,722)
Change in net assets	<u>2,824,998</u>	<u>(326,962)</u>	<u>2,498,036</u>
Net assets:			
Beginning of year	3,773,928	2,072,159	5,846,087
End of year	<u>\$ 6,598,926</u>	<u>\$ 1,745,197</u>	<u>\$ 8,344,123</u>

South Dakota Public Assurance Alliance

Combining Schedules of Cash Flows

Year Ended December 31, 2008

	Casualty	Property	Total
Cash Flows From Operating Activities			
Operating contributions received	\$ 5,865,376	\$ 2,859,159	\$ 8,724,535
Reinsurance premiums paid	(916,388)	(459,297)	(1,375,685)
Losses and loss adjustment expenses paid	(4,137,824)	(2,101,746)	(6,239,570)
General and administrative expenses paid	(1,235,322)	(619,664)	(1,854,986)
Net cash used in operating activities	(424,158)	(321,548)	(745,706)
Cash Flows From Noncapital Financing Activities			
Cumulative Reserve Fund contributions received	155,796	-	155,796
Cumulative reserve contributions paid	(23,722)	-	(23,722)
Net cash provided by noncapital financing activities	132,074	-	132,074
Cash Flows From Investing Activities			
Debt securities:			
Purchases	(5,534,768)	-	(5,534,768)
Maturities and calls	4,102,044	-	4,102,044
Repayments on mortgage-backed securities	996,474	-	996,474
Proceeds from maturities of certificates of deposit	776,500	-	776,500
Purchases of certificates of deposit	(1,802,418)	-	(1,802,418)
Interdivisional amounts	723	(723)	-
Investment income received, net of investment expenses	990,316	17,280	1,007,596
Net cash provided by (used in) investing activities	(471,129)	16,557	(454,572)
Net decrease in cash and cash equivalents	(763,213)	(304,991)	(1,068,204)
Cash and Cash Equivalents			
Beginning of year	1,429,576	583,969	2,013,545
End of year	\$ 666,363	\$ 278,978	\$ 945,341
Reconciliation of operating income (loss) to net cash provided by operating activities:			
Operating income (loss)	\$ 910,586	\$ (344,242)	\$ 566,344
(Increase) decrease in assets:			
Contributions receivable	85,002	100,159	185,161
Reinsurance recoverable on paid losses	(79,963)	(6,934)	(86,897)
Prepaid expenses	(15,124)	(5,117)	(20,241)
Increase (decrease) in liabilities:			
Losses and loss adjustment expense reserves	(1,442,733)	64,720	(1,378,013)
Accounts payable and accrued expenses	25,990	(3,320)	22,670
Unearned contributions	92,084	(126,814)	(34,730)
Net cash used in operating activities	\$ (424,158)	\$ (321,548)	\$ (745,706)
Supplemental Disclosure of Noncash Investing and Financing Activity			
Net increase in the fair value of investments	\$ 681,640	\$ -	\$ 681,640